$40.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

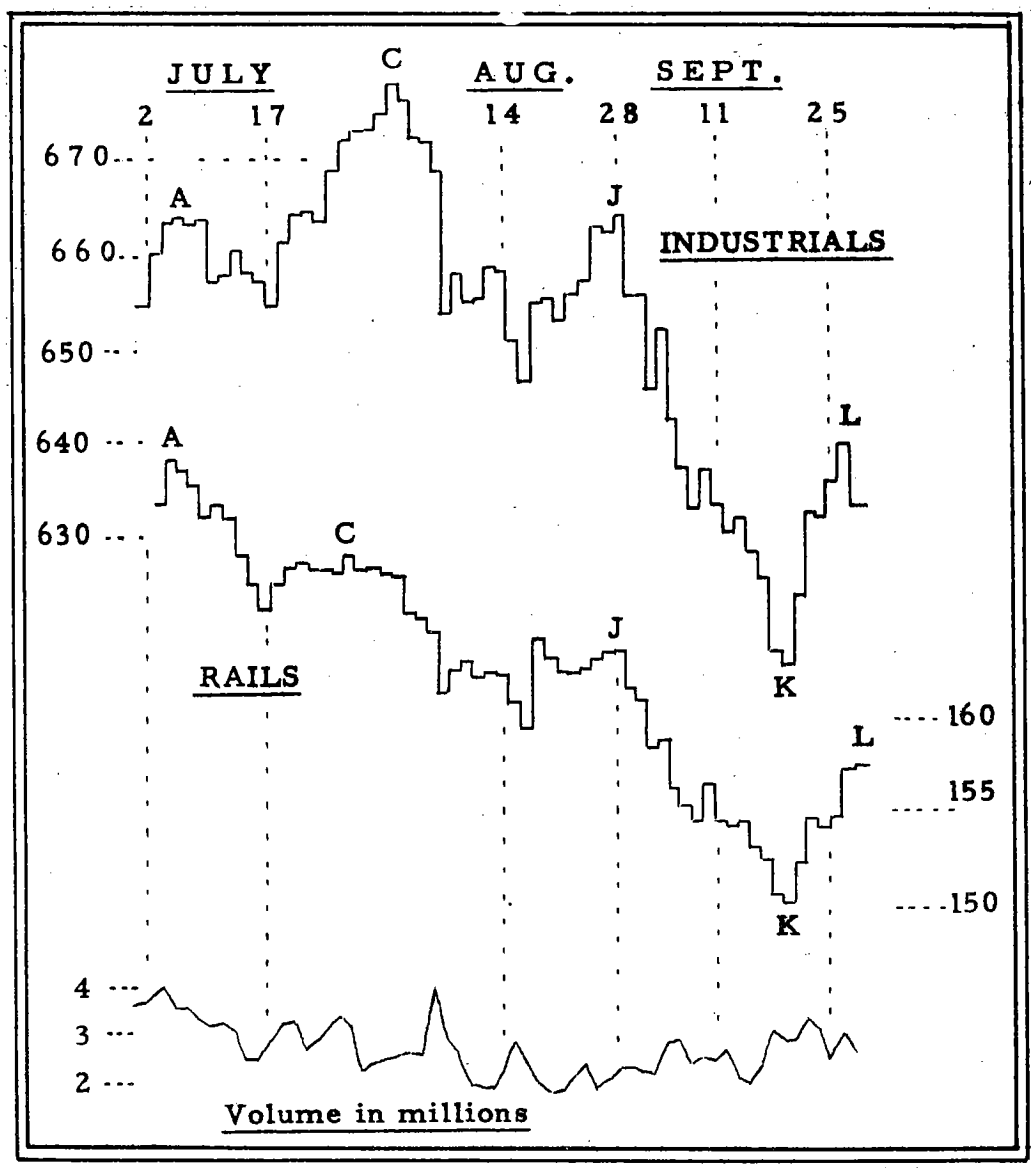
RICHARD RUSSELL
125 East 93rd Street
New York City 28

Registered with the Securities and Exchange Commission

Copyright 1959 - Richard Russell

BULL OR BEAR MARKET? The question uppermost in the minds of all Dow Theorists is, "Has the tide turned?" Readers who still own stocks are betting that the recent recession is merely another secondary reaction in a continuing bull market. They point to that principle of orthodox Dow Theory which states that a primary trend is taken to continue in force until countermanded by a valid reversal signal. Rather than sell too soon, they will attempt to unload if and when a bear market is actually signaled.

Those who have sold their stocks have elected to "insure" themselves against a possible disaster. Moreover, they feel that the recent unsatisfactory action of the averages, when weighed against capital and profits built up over many years, provides ample justification for retiring from the market. Sellers can also point to the Dow Theory axiom which says that any reaction in the third phase of a primary bull market may subsequently prove to have been the first leg of a primary bear market. As a final argument, those who have swapped their stocks for cash note that: (1) the actual bear signal usually occurs some distance from the top; (2) it is not always easy to sell stocks in a liquidating market following a bear signal. Because I need whatever sleep I can get, I chose (a few months ago) to join the ranks of those who "stand and wait" on the sidelines.



There are certain characteristics of the price movements during bear markets which have, on occasion, provided Dow Theorists with early clues as to a possible primary reversal. The action of the market during primary bull and primary bear markets is fundamentally different, and for this reason, readers should study the following quotes carefully (the underlines are mine).

Hamilton wrote that "...in a primary bear market the rallies are apt to be violent and erratic, and always occupy less time than the decline which they partially recover.

In a bull market the reverse is true."

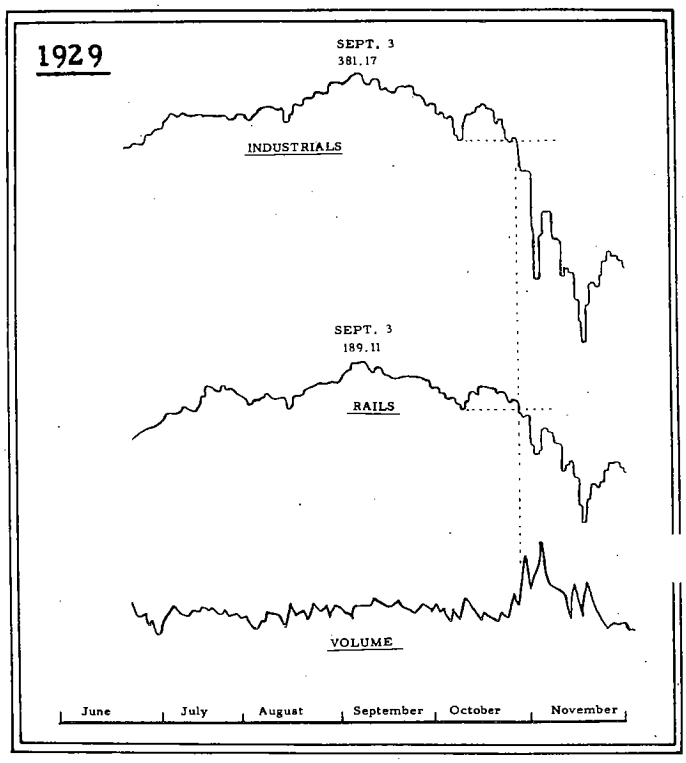
Regarding bear markets, Rhea added, "Often the primary movement (downward) of several weeks is retracted in a few days."

In the light of these statements, the recent action of the market is worth analyzing. Referring to the entire C-K decline in industrials (see chart), this movement was accomplished in a period of 35 trading days, during which time industrials lost a total of 61.65 points. On the explosive 5 day rally from K to L, however, industrials rebounded 23.65 points. In other words, 38% of the losses sustained on the 35 day C-K decline were retraced in the remarkably short time of 5 trading days (as of this writing the rally from K may or may not be over). When these movements are compared with other bull market declines and advances, one must conclude that they are rather unusual. The rail decline (A-K) from the July 8 high lasted 52 days. During this time rails lost 23.85 points, yet in the space of the same 5 days (the K-L rally), rails recouped 6.85 points or 30% of their total losses. This is also a somewhat surprising comparison.

The fact that volume expanded on the K-L rally could be, of course, an encouraging indication. Ordinarily, expanding volume on a rally is bullish, but when it is a case of accepting volume or price indications, I prefer to use the latter. As a matter of interest, Dow, and Hamilton in his early writings, took little note of volume. They were of the opinion that volume (as well as every other factor) was discounted in the price movements. In his later writings, Hamilton made increasing use of volume as a tool in interpreting the Dow Theory, and Rhea took note of volume in almost all his writing.

There are no fixed rules regarding time required for a full correction of a bull market secondary reaction (or a bear market primary swing -- whichever the current case may be), but a movement of a few weeks or longer is generally desirable. The importance of a full correction is that a bear signal can be given only after the preceding reaction has been fully corrected. Without a complete correction, we may merely have a minor rally in a continuing downward swing.

I have included a chart (daily price movements and volume) of the great 1929 top in order to aid readers in points of comparison. From the highs of September 3, 1929 (see chart), a reaction lasting 5 weeks occurred, and, of course, few suspected at the time that this was the first leg of a bear market. Following the "reaction", which erased 56.00 and 20.85 points from industrials and rails respectively, a rally of only 6 days ensued. This rally recouped 49.5% of the reaction losses in each average. Volume on the rally tended to contract, and despite the short duration of the retracement, the advance served as a full correction of the preceding reaction. When this 6 day rally fizzled, both averages turned down and subsequently violated their previous reaction lows on huge volume, thus providing a classic bear signal.



THE TEST. In my opinion, the present rally from K has served to correct the reaction from the July-August highs, both in extent and duration (although I would prefer to see it last a few days longer). When the current advance ends, if the two averages decline on diminishing volume and one or both averages hold above

the previous K lows (industrials 616.45, rails 150.28), it will be the first bullish indication. If an advance then takes both averages over their L highs on increasing volume, the secondary trend will have turned up.

On the other hand, if, following the termination of the current K-L advance, the averages turn down, and they both violate the K lows on heavy volume, the primary trend will have turned bearish. In this event, I wish to stress again that those who hold stock will be swimming against the most powerful force in the market, the primary tide. I know of no better way of "going broke" than to remain invested during a primary bear market.

(Written the morning of September 30th)

Today's market action (September 30th) was, to say the least, unusual. Against a drop of over 8 points in industrials, the rails actually advanced 0.27. One day's divergence may not be particularly significant, but it must be admitted that the two averages took spectacularly separate paths. Veteran Dow Theorists have learned to tread carefully when the "wheels of the market are grinding".

(Above paragraph written September 30th, after the close)

SECURITIES. Because of the possibilities inherent in the current price structure, I continue to advise the purchase of 91 day Treasury bills. They are now yielding over 4% in a market that is subject to money pressures unlike anything seen since the early 1930's. The 91 day bills are the first call on the Treasury of the United States, and the total taxing power of the U.S. Government stands behind them. They may be purchased (commissions are extremely low) at commercial banks or brokerage offices.

NOTE. Readers may be amused by the article in the current issue of Fortune Magazine (October) entitled, "Stock-Market Letters: A Growth Situation". The flavor of the article may best be judged from the blurb which states: "Luckily for the men who produce stock-market literature, their success does not depend on their records as forecasters." It is too bad that Hamilton's and Rhea's records could not have been included, but, of course, Fortune was only interested in the more prominent soothsayers of the present day.